Supreme Court, U.S.
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No. 04-1720

In The

Supreme Court of the United States

WALTER L. MEDLIN,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether a taxpayer realizes taxable gain under Section 1001(b) of the Internal Revenue Code as a result of the foreclosure sale of property pursuant to a mortgage given by the taxpayer to secure a personal guarantee for a third party when the taxpayer received no economic benefit from the loan, did not include the guaranteed loan in the properties basis, and received no money or other property from the foreclosure sale.

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OPINION BELOW

The Court of Appeals entered an unpublished *per curiam* affirmed opinion (App. 1-2). The opinion of the Tax Court (App. 6-178) is unofficially reported at T.C. Memo 2003-224; 2003 WL 21743513.

JURISDICTION

The judgment of the court of appeals was filed on March 23, 2005. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved herein:

26 U.S.C. § 61, Gross income defined, etc.

(a) General definition

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

(b) Cross references

For items specifically included in gross income, see part II (sec. 71 and following). For items specifically excluded from gross income, see part III (sec. 101 and following).

26 U.S.C. § 1001. Determination of amount of and recognition of gain or loss

(a) Computation of gain or loss.

The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) Amount realized

The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the amount realized –

(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under section 164(d) as imposed on the purchaser and

(2) there shall be taken into account amounts representing real property taxes which are treated under section 164(d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

(c) Recognition of gain or loss.

Except as otherwise provided in this subtitle, the entire amount of the gain or loss, determined under this section, on the sale or exchange of property shall be recognized.

(d) Installment sales

Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

(e) Certain term interests

(1) In general

In determining gain or loss from the sale or other disposition of a term interest in property, that portion of the adjusted basis of such interest which is determined pursuant to section 1014, 1015, or 1041 (to the extent that such adjusted basis is a portion of the entire adjusted basis of the property) shall be disregarded.

(2) Term interest in property defined

For purposes of paragraph (1), the term "term interest in property" means –

(A) a life interest in property,

(B) an interest in property for a term of years, or

(C) an income interest in a trust.

(3) Exception

Paragraph (1) shall not apply to a sale or other disposition which is a part of a transaction in which the entire interest in property is transferred to any person or persons.

STATEMENT OF THE CASE

The Commissioner determined a deficiency in the Petitioner's taxes for the years 1985-1988. A Petition was

filed in United States Tax Court contesting the determination. A trial in United States Tax Court was held which resulted in a 174 page opinion. (App. 6-178) The Petitioner filed on appeal to the United States Court of Appeals for the Eleventh Circuit seeking review of the Tax Court judgment pursuant to 26 U.S.C. § 7482(a).

Petitioner raised two issues, only one of which is the subject of this Petition. The issue raised below was, "whether the Tax Court erred in holding that Appellant realized gain from the foreclosure sale of his property that had been mortgaged to secure an accommodation guarantee by Medlin".

The Circuit Court affirmed without opinion by issuing its *per curiam* Affirmed judgment (App. 1-2). The Tax Court opinion at Appendix 78 through 83 addresses the issue relevant to this Petition. The Tax Court ruled that Medlin received taxable gain from the foreclosure of a mortgage which had been given as collateral for his personal guarantee of a loan to an unrelated third party. The Taxpayer received no economic benefit from the guaranteed loan nor did he receive any proceeds from the foreclosure sale. The sale resulted in a credit of $87,000.00 toward the reduction of the Petitioner guarantee debt.

On September 7, 1977, Petitioner acquired the real property at issue through a trustee for $1,837.54. (App. 78) In 1982, Combank loaned $120,000.00 to Cramer Hoffman & Haber, P.A., and Petitioner guaranteed the promissory note and gave a mortgage to secure his guarantee of the loan to Cramer, Hoffman & Haber, P.A.

Freedom Savings and Loan Association of Tampa, Inc. (herein after Freedom) (the successor to Combank) filed a foreclosure action in 1983 to foreclose the mortgage (App.

78). The property was sold pursuant to the foreclosure action on November 25, 1985 and title conveyed to Freedom. (App. 79) Freedom purchased the properties for a bid of $10,000.00.

In 1983, Freedom filed a separate action for judgment against Petitioner on the guarantee (App. 79). In 1986, Freedom filed a motion for final judgment with the only issue being the value of the property sold pursuant to the foreclosure sale in 1985. The state circuit court determined that the fair market value of the property at the time of the foreclosure sale was $87,000.00, and that Petitioner owed $20,834.00 on his guarantee obligation (App. 79).

The Tax Court found that Medlin's basis in the property was $1,844.00 at the time of the foreclosure sale. (App. 80)

The Commissioner originally determined that Medlin had realized cancellation of indebtedness income in relation to Medlin's guarantee but conceded that determination (App. 80). The Commissioners raised as a new matter that the taxpayer had realized gain of $112,156.00 from the foreclosure sale in 1985. (App. 80)

The Tax Court agreed with the Commissioner and held that Medlin realized a gain as a result of the foreclosure sale. The Tax Court determined that the fair market value of the property was $87,000.00 as found by the Florida Circuit Court and therefore reduced the gain as computed by the Commissioner. (App. 80-83) The Tax Court determined a gain of $85,156.00 by subtracting the basis of $1,844.00 from the $87,000.00 which was determined to be the "amount realized" from the foreclosure sale. (App. 83)

The Tax Court ruled that the foreclosure sale represented a sale or exchange for tax purposes. The Tax Court ruled that the amount realized from the sale of the property included the amount of liability from which the taxpayer as transferor, was discharged as a result of the sale. (App. 81)

The Tax Court's ruling creates a precedent that is contrary to the Sections 1001 and 61(a)(12) of the I.R.S. Code and the rulings of this Court.

REASONS FOR GRANTING WRIT

The Tax Court decision establishes a precedent which will have a significant adverse impact on various segments of the economy. The practice of obtaining guarantees on loans is widespread and touches on diverse endeavors such as start-up businesses, real estate development, commercial loans to existing businesses and even student loans.

The ability of a borrower to obtain a loan from a financial institution often rests upon providing the lender with another person ready and willing to guarantee the loan. Lenders often will require the guarantor provide collateral to further secure the loan. The ability of a borrower to produce a guarantor who is willing to collateralize the guarantee will be significantly and negatively impacted by the precedent established by the Tax Court in this case.

The Tax Court's opinion creates precedent which is contrary to I.R.S. Code § 1001(b) by expanding the definition of the amount realized in computing gain.

Section 1001(b) of the I.R.S. Code sets forth that the amount realized from the sale or other disposition of property is the sum of any money received plus the fair market value of property received. In this case, the Petitioner received no money or other property as a result of the foreclosure sale. The Petitioner had guaranteed a loan for which he received none of the loan proceeds and no other economic benefit. When the bank foreclosed on the mortgage given to secure the guarantee, the Petitioner received none of the proceeds from the foreclosure sale. Rather, the bank acquired the property for a $10,000.00 bid. In a subsequent proceeding, the state Court found the value of the property to be $87,000.00, thereby reducing the guaranteed debt by that amount.

The Tax Court's error stems from the improper application of the principle enunciated in *Commissioner v. Tufts*, 461 U.S. 300 (1983) that the amount realized from a sale of property includes any loan amount satisfied by the sale.

The Tax Court's decision will add to the risks of a guarantor, for a guarantor will not only face the potential obligation to pay the debt, but also to pay income tax as a result of the foreclosure sale to satisfy the debt.

In *Commissioner v. Tufts*, 461 U.S. 300 (1983) and *Crane v. Commissioner*, 331 U.S 1 (1947), this Court recognized that a foreclosure sale results in a gain for the taxpayer by the amount of the loan proceeds satisfied. The rationale for including the satisfied loan as gain was that the taxpayer received a non-taxable increase in wealth when the loan was obtained.

> When a taxpayer receives a loan, he incurs an obligation to repay that loan at some future date. Because of this obligation, the loan proceeds do